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DEPARTMENT FOR E, NEA/FO, EEB/FO, EEB/IFD, AND NEA/ARP (MCGOVERN)

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TAGS: [EFIN](#) [ECON](#) [PGOV](#) [AE](#)  
SUBJECT: DUBAI WORLD "DEFAULTS"

REFS: A) DUBAI 505  
B) DUBAI 491 AND PREVIOUS  
C) DUBAI 457  
D) ABU DHABI 1008  
E) DUBAI 253  
F) ABU DHABI 464  
G) ABU DHABI 189

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CLASSIFIED BY CDA DOUG GREENE FOR REASONS 1.4 (B AND D).

This message drafted jointly by Embassy Abu Dhabi and Consulate  
General Dubai

11. (S/NF) Summary: On November 25, the Government of Dubai announced that parastatal conglomerate Dubai World had requested a debt standstill from creditors. The news shocked international investors, who had long expected Abu Dhabi to continue to bailout its neighbor's massive debt under the rubric of "too big to fail." While Abu Dhabi officials report they do stand behind Dubai, and the UAE Central Bank has stepped in to support liquidity in the banking sector, key officials in both cities now report a distinction has been made between public and private entities. In the short term, Dubai is likely to be forced to undertake significant management and financial reform, improve transparency and sell off key Dubai Inc. assets in order to revitalize what is arguably the Gulf's economic heart. The situation continues to unfold, but also raises new concerns about the health of the UAE banking sector and economy, which we will be watching carefully in the days ahead. More broadly, Dubai's woes highlight that the UAE remains a developing country - both politically and financially - and highlights weaknesses that may find parallels in other economies in the region. End Summary.

#### WHAT HAPPENED -----

12. (SBU) On November 25, the Government of Dubai announced that parastatal Dubai World had requested a debt standstill from creditors. Under the plan, Dubai World would effectively cease payments on its USD 59 billion in debts until May 30, 2010. Markets and analysts quickly read the request as the likely first step to a subsequent default, specifically of Dubai World subsidiary Nakheel's USD 3.5 billion dollar Islamic sukuk (bond) which comes due December 14 (Ref B). (Note: International bankers told EconOff that one U.S. pension fund holds 10 percent of this bond. End Note.) The announcement, coming on the eve of a UAE government holiday through December 5, surprised many analysts who expected Abu Dhabi would support Dubai's largest entities, regardless of the cost.

13. (C/NF) This is a stunning turn of events for the huge Dubai-based conglomerate, that began as operator of Dubai's ports and the Jebel Ali Free Zone and quickly expanded overseas in the 1990s. Dubai Ports World (DP World) went on to acquire P&O in 2006, only to sell off P&O's U.S. assets after Congressional opposition to the investment. (Note: Subsidiaries Dubai Ports World and the Jebel Ali Free Zone Authority are reportedly not included in the standstill request. End Note.) Along the way, Dubai World branched into real estate development and, through its subsidiary Nakheel (Arabic for date palm), became one of the largest land holders in Dubai. Nakheel created some of Dubai's most famous landmarks, including the Palm Islands and The World developments. Dubai World's investment firm Istithmar purchased international landmarks, like the QE 2, Miami's Saks Fifth Avenue's clothing store. The majority of Dubai World's expansion was financed by debt, which investors were led to believe was backed by the Government of Dubai.

14. (C/NF) The timing of the debt standstill announcement created tremendous anxiety among investors, as it generated hundreds of questions but gave no clear details on who was in charge. On November 26, official news agency WAM released an official statement from Sheikh Ahmed bin Saeed Al Maktoum, Chairman of Dubai's Supreme Fiscal Committee (Ref E). Sheikh Ahmed, who is also the Chairman of Emirates Airline, stated the "intervention in Dubai World was carefully planned and reflects its specific financial position...We understand the concerns of the market and the creditors in particular. However we have had to intervene because of the need to take decisive action to address its particular debt burden." Dubai also announced on November 25 that Aidan Birkett, a senior Deloitte restructuring expert, would oversee the Dubai World restructuring effort on behalf of the Dubai Financial Support Fund.

#### WHAT IT ALL MEANS -----

15. (S/NF) Over the past year, UAE federal and emirate-level officials unequivocally told EmbOffs that local and foreign investors and contractors who profited from Dubai's boom in years past must also share in any subsequent downturn (Ref C). Similarly, senior

officials now seem to be drawing a clear line between

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public/government obligations and the debt of quasi-government entities, like Dubai World, that are no longer assured of receiving a government bailout. This apparently new policy may be the result, at least partially, of mismanagement of the original USD 10 billion "bailout" by the UAE Central Bank (read: Abu Dhabi) in February (Ref G). Contacts report some of these funds were transferred to Nakheel, who then paid executive bonuses, rather than debts or obligations to contractors. While many in Dubai may have once blurred the line between sovereign and commercial entities, Dubai and Abu Dhabi officials are now reporting there is a clear distinction. (Note: Abu Dhabi was apparently caught off guard by the announcement. Several well-placed contacts reported they had no prior notice of the announcement. End Note.)

16. (S/NF) Key officials in both emirates long-recognized the moral hazard risks of a government bailout, but no one seemed to know for sure how much support Abu Dhabi or Dubai would ultimately offer to firms like Nakheel. Many foreign analysts argued that the reputational risk -- and associated increase in financing costs -- made a default or quasi-default unpalatable to both Dubai and Abu Dhabi. In the end, despite many public claims to the contrary, Dubai failed to raise the funds it needed to buy its way back from the brink. The funds from the UAE Central Bank in February (USD 10 billion) and Abu Dhabi based National Bank of Abu Dhabi and Al Hilal Bank in late November (USD 2.5 billion each) are now reportedly being carefully managed by a handful of senior technocrats within the Dubai Department of Finance. But it was not enough to pay off the vast debt acquired by Dubai World.

#### THE WAY FORWARD FOR DUBAI

17. (S/NF) This announcement, coming on the heels of major personnel changes in key Dubai financial entities (Ref A), is likely the first of an ongoing process of shoring up Dubai's ailing economy. Dubai's old guard is increasingly being selected to reign in Dubai's infamous irrational exuberance and big-spending ways of its increasingly sidelined "young turks". In his public statement, Sheikh Ahmed explicitly promised to provide additional details in the coming week, confirming that the story is far from over. In the short term, Dubai's sovereign and private entities will only be able to attract additional financing at very high prices. Several weeks ago, Emirates NBD, the largest bank in the UAE (by assets), had to scrap plans to raise cash in the debt markets because spreads were too high. In contrast, better managed Dubai Government entities like Dubai Civil Aviation Authority have recently repaid and refinanced debt.

18. (S/NF) The standstill announcement may help pave the way for proper asset pricing in Dubai. Robert Bush, the Managing Partner for Dubai-based Majilis Capital told EconOff that Abu Dhabi investors may now look for new opportunities at rock bottom prices. Bush reported that these investors determined in the spring of 2009 that the assets being offered were over valued. However, the necessity of selling off assets is a new reality for Dubai, which reportedly turned away interested foreign investors in past months. Dubai's most attractive assets (e.g. Dubai Ports World, Emirates Airlines) are also the most unlikely to be sold, as they form the bedrock of Dubai's economy -- and revenues -- now that real estate sector has tanked. However, there is a sense that Dubai's "old guard" believes foreign investments should be divested in order to shore up the local economy.

#### ...AND THE COUNTRY

19. (S/NF) In the immediate future, the potential impact on the UAE's banking sector is a major cause for concern. Coming on the heels of Saudi Arabia's Saad/Al Gosaibi default (Ref D), local banks face growing balance sheet weaknesses. One senior Abu Dhabi financial official reported the Emirate is looking closely at the banking sector, with an eye to shoring up banks as needed. On November 29, the Central Bank announced it had established a liquidity facility to support local and foreign banks with branches in the UAE. Separately, the UAE private sector is also likely to face a crisis of confidence, as the reality sinks in that Dubai World entities are also unlikely to pay back their debts to contractors in the coming months. Similarly, U.S. firms owed money by Dubai entities are also likely to continue to face significant payment delays.

110. (S/NF) Addressing Dubai's financial woes is challenging the UAE's consultative decision making process and senior officials' financial knowledge. While foreign experts are clearly involved, the sensitivities are vast, further complicating the speed and accuracy of a resolution. On the surface, the UAE, especially Dubai, may appear to be a developed economy, but in most ways it is very much a developing country, with all of the related weakness of institutions, oversight, and regulatory structures (Ref F). Senior Dubai financial

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officials tell EmbOffs they recognize the need for financial sector reform and are already looking at how to establish appropriate oversight. However, these comments were circulating a year ago, and little has been done to improve capacity.

#### COMMENT

111. (S/NF) Substantively, little in Dubai's financial situation has changed in the past week. Rather, Dubai has finally publicly admitted to the overwhelming challenge of servicing its debts. What has shocked the markets and investors is the realization that neither Dubai nor Abu Dhabi is planning to step in and rescue Dubai's most troubled parastatals. Among the key questions still need to be

answered include how does Dubai move forward and the effect on the balance of power between Abu Dhabi and Dubai. The short- and medium-term impact on the UAE economy, and the region more broadly, also remains to be seen. With the slowdown for the extended 'Id al-Adha and National Day holidays (Nov. 26-Dec. 5), and similar closures elsewhere in the Gulf, it will take some time before the path ahead is clear. End Comment.